

EX PARTE OR LATE FILED



DOCKET NO. 96-45

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October 31, 1996

William F. Caton  
Acting Secretary  
Federal Communications Commission  
1919 M Street, N.W. Room 222  
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION  
OFFICE OF SECRETARY

**EX PARTE: Federal-State Joint Board on Universal Service  
CC Docket No. 96-45**

Dear Mr. Caton:

I am writing to respond to letters filed recently by MCI Communications Corporation ("MCI") and by Teleport Communications Group ("TCG") raising concerns with respect to GTE's proposal to establish universal service funding on the basis of competitive bidding. It is interesting that these supposedly market-driven companies should be so unwilling to participate in a simple, head-to-head competition to determine support levels in the future, preferring instead to rely on traditional, cost-of-service regulation. These parties appear to believe that they stand to win more by arguing over cost models than they could by actually performing as a universal service provider. In their letters, MCI and TCG manufacture artificial problems with the auction process, while ignoring the clear benefits that auctions will bring: replacing a regulatory decision with a market-based process, providing a more accurate measure of the level of support that is really needed, and creating incentives to minimize the need for support over time.

MCI and TCG also appear to misunderstand GTE's auction proposal. GTE does not propose that each area be auctioned twice each year, or that geographic boundaries of the serving areas be adjusted for each auction as TCG suggests. Nor is the right to receive support dollars necessarily exclusive, as MCI asserts. In fact, if carriers have costs which are reasonably competitive as indicated by their bids they will be selected as COLRs and will receive support under GTE's proposal. Further, in the unlikely event that the incumbent LEC is the sole COLR selected as a result of the auction, GTE has proposed that another carrier could notice the area for another auction at any time; the three-year commitment period would only apply in the event that a new COLR assumed the obligation.

Both MCI and TCG suggest that requiring a new entrant to submit a bid to compete for universal service support is a barrier to entry. Perhaps these parties also feel that having to compete for customers is a barrier to entry. Companies bid on contracts all the time in competitive markets; GTE's auction proposal is no different. If a new entrant cannot submit a bid which is competitive with those of other carriers, how would it propose to bid for customers' business in the

competitive marketplace? What will create an artificial barrier to entry is a plan which sets support purely on the basis of a cost estimate, with no mechanism for adjusting the support level based on a market observation. No matter how the initial cost estimates are derived, the one thing that we can be sure of is that they will be wrong. In areas where the support is set too low, the "price" potential entrants see, which is the sum of the support payment and the price the customer pays, will also be too low, and they will be deterred from entering. In those areas, the incumbent -- the only carrier without a choice in the matter -- will be stuck as the universal service provider. GTE's auction proposal is the only proposal that addresses this problem. It would allow a new firm to enter any market, providing a fresh opportunity to establish a correct support level -- based on what carriers are actually willing to do in the marketplace -- for each area.

MCI and TCG also suggest that the fact that some carriers may win the auction, while others may lose, will artificially limit subsequent competition. In fact, an entrant could only be excluded under GTE's auction proposal if its costs are so much higher than those of other bidders that it would require a substantially higher support payment; even in that case, the exclusion would only be temporary. Further, GTE's proposal is based explicitly on a framework of analysis which considers the trade-offs between promoting competition, minimizing costs, and minimizing the level of support. State commissions are free to set the parameters of the proposed framework to achieve any desired balance among these objectives. They cannot, as MCI and TCG seem to suggest, simply assume these trade-offs away.

MCI argues that carriers will be excluded from realizing possible synergies across different areas. In fact, GTE's proposal would allow a new carrier to prompt bidding on any number of market areas, in any combination it wishes. Such a carrier would not receive support in a given area only if its support requirements -- including the presumed synergies-- were uncompetitive with those of other carriers bidding in that area. Even in that case, the entrant would be free to operate in any area it chooses, and so would be able to realize these synergies -- it simply would not be entitled to support in areas where it loses the bid. In fact, preliminary cost analysis performed by GTE using the BCM II model suggests that the synergies MCI alludes to would be very small. Further, GTE has suggested to the staff alternative auction designs which would explicitly address synergies, if the Commission chose to do so.

Finally, TCG suggests that the auction process would be administratively difficult. The relevant question here is - compared to what? The Joint Board and the FCC has examined various proxy models for more than a year now, without arriving at a method for estimating costs which is as reliable as the auction process would be. The cost modeling is complex and contentious. Further, contrary to TCG's assertion, the cost models would have to be updated regularly to account for changes in cost over time, for changes in technology, and for changes in the definition of "core" service -- all of which would be handled automatically by an auction process. The California Commission, which TCG cites, pointed out these concerns to the Joint Board in its comments, and has just adopted an order in which it set forth a

Mr. William F. Caton

Page - 3

proceeding to examine the use of auctions in the future as a means for adjusting support over time. The auction process proposed by GTE is a relatively simple, single-round auction which would be easy to administer.

Please let me know if you have any questions regarding this matter.

Sincerely,



Whitney Hatch

c: William F. Caton, Acting Secretary  
Federal State Joint Board Commissioners and Staff  
D. Gonzales  
T. Dale  
J. Morabito